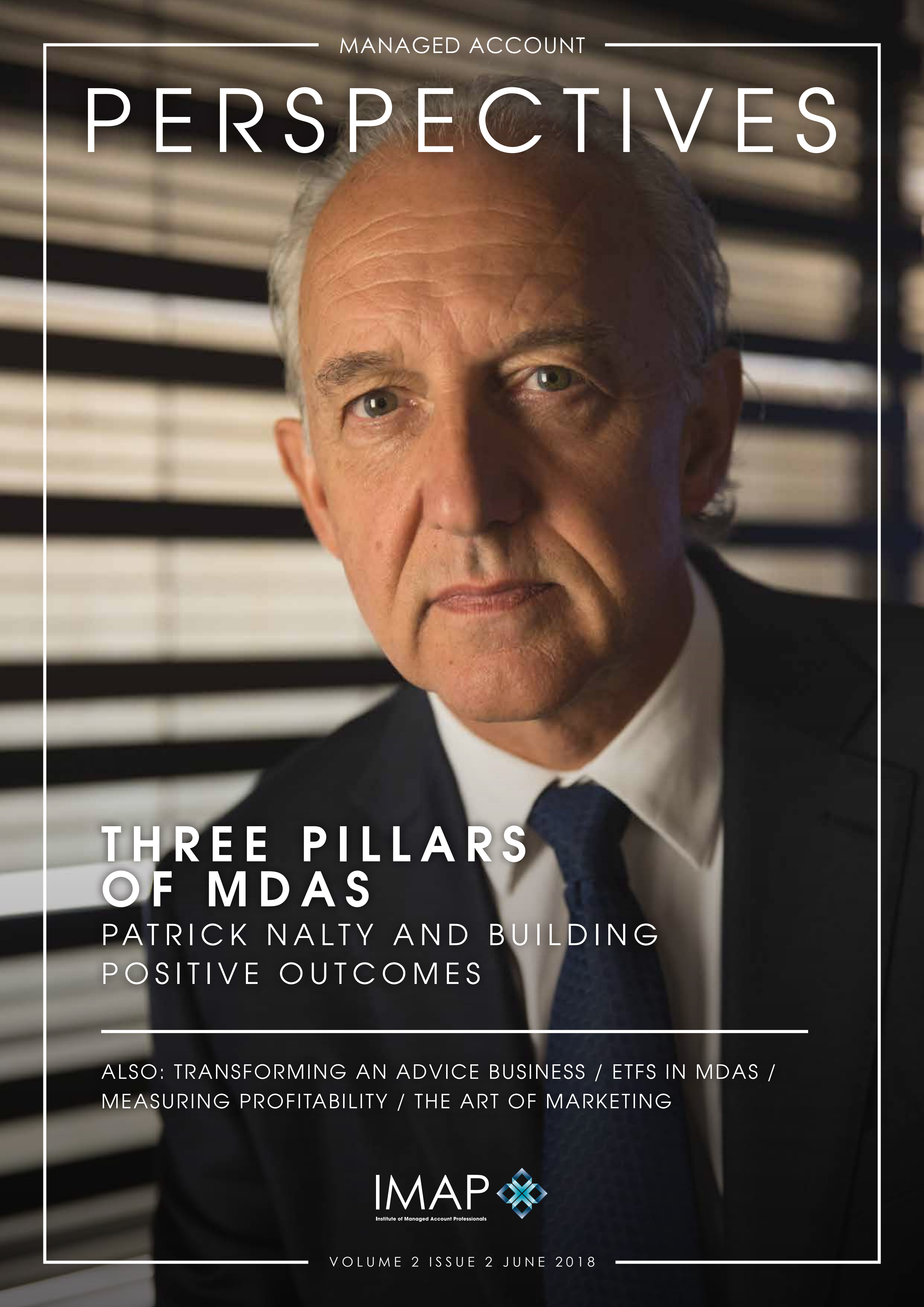

MANAGED ACCOUNT

PERSPECTIVES

THREE PILLARS OF MDAS

PATRICK NALTY AND BUILDING POSITIVE OUTCOMES

ALSO: TRANSFORMING AN ADVICE BUSINESS / ETFS IN MDAS / MEASURING PROFITABILITY / THE ART OF MARKETING

IMAP
Institute of Managed Account Professionals

VOLUME 2 ISSUE 2 JUNE 2018

PERSPECTIVES

REGULAR

FEATURE

Managed Account Perspectives is the official publication of the Institute of Managed Account Professionals Ltd (ABN 57 125 794 274).
IMAP was formed to act as the nexus in this increasingly important part of the advice profession. Our aim is to bring together advisers, managers, platforms and other managed account service providers to help build a better industry.

www.imap.asn.au
contactus@imap.asn.au

Editor: Jayson Forrest
M: +61 416 039 467
E: jaysonjforrest@gmail.com

Publisher: Toby Potter
M: +61 414 443 236
E: toby.potter@imap.asn.au

MANAGED ACCOUNTS POST ROYAL COMMISSION

The adoption of managed accounts over the past three or four years – there is now approximately $60 billion invested in various forms of SMA and MDA – has been driven by a number of separate factors. These are:

- An attempt to achieve greater practice efficiency among advisers;
- A desire by advisers to deliver better, more precise client outcomes;
- Technology developments that have enabled the systematic, model-based management of many portfolios; and
- A strategic trend for advice businesses to move towards wealth management. This has meant different pricing models.

If the last of these clashes with regulatory change, will the other three drivers be derailed?

All forms of managed accounts are subject to the existing FOFA regulations relating to conflicted remuneration, just like any other financial product. Indeed, SMAs are generally registered managed investment schemes and are subject to identical restrictions to those which apply to unit trusts.

However, it's worth considering how a tighter regulatory regime might impact the key drivers that I have set out above as central to the growth in managed accounts.

Practice efficiency

Whether an AFSL obtains revenue from their managed account service or not, the efficiency gains from managed accounts are substantial. Advisers will continue to seek improvement in their office efficiency.

Better client outcomes

By adopting a managed account structure, particularly multi-asset class models, advisers recognise that client outcomes will be improved in several ways:

- Efficient implementation of tactical changes;
- Client portfolios receiving continuous review, rather than annual ad hoc review. This makes the advice fee easier to validate;
- Use of listed investments that was previously seen as impractical by many advisers. Generally this has meant a lower cost of investment;
- Establishment of central investment teams, with an increase in the level of experience and skill applied to portfolios; and
- Other cost reductions, particularly in fund manager's MERs and often platform costs. The benefit of this flows directly to the client.

Taken in aggregate, these factors lead to better client portfolio outcomes. None of these issues are likely to be reduced in their impact by regulatory change.

Technology

One of the impediments to the adoption of managed accounts was the inability to implement them on major platforms. Every one of the large platforms is now well advanced in implementing this capability. Again, no likely regulatory change will cause these developments to be withdrawn.

Charging for portfolio management services

The development of more rigorous portfolio management capability often involves external consultants or directly contracted investment managers, and comes at a cost. Advice groups either absorb this cost or levy a portfolio management fee on clients to cover it.

For the groups who absorb it as a cost of achieving the benefits outlined above, any regulation change will likely be a matter of indifference. For groups that recover these costs, there are well established client consent processes they can apply.

So, without wishing to seem like a Pollyanna, we don't think there will be a material negative impact on the trend to migrate significant existing advised assets into managed account structures.

Toby Potter
Chair

You know your clients. And we know investing.

Available through advisers like you, **Morningstar's Managed Accounts** are designed, built and monitored by our experienced investment team. We offer a range of portfolios to help you meet your clients' individual goals. All portfolios are built for the long term and managed with a keen eye on risk.

Our managed accounts can help enhance your investment offerings, strengthen client relationships and streamline your business. Together, we bring your clients the best of both worlds: A financial plan you've developed specifically for their needs that includes all of the advantages of professional portfolio management. We'll allocate the assets, so you can spend more time with your clients.

Recep Peker

REPORT CONFIRMS ADVISER ADOPTION OF MANAGED ACCOUNTS

An ever increasing number of financial advisers are implementing managed accounts in their practices, citing cost effectiveness, operational efficiency, transparency and improved financial outcomes for clients, as key reasons for the move.

These were some of the key findings coming from the 2018 NAB/Investment Trends Managed Accounts Report, which is based on a survey of 841 financial advisers. The report found that over the last 12 months, the proportion of advisers who recommend managed accounts or intend to use these solutions increased 18 per cent – growing from 46 per cent to 64 per cent.

"The adoption of managed accounts by financial advisers has continued its steady rise over the last year, with 30 per cent of practitioners now using these solutions for client investments," said Investment Trends' Research Director, Recep Peker.

"The 2018 results reveal a marked surge in interest in using managed accounts, with advisers recognising considerable benefits for clients, as well as the efficiency benefits in implementing advice recommendations."

Client benefits

A significant finding identified in the report is that advisers are continuing to see the advantages of using managed accounts for their clients.

Among advisers who recommend managed accounts, 75 per cent agreed that as a result of using these solutions, clients outcomes had improved, and 59 per cent said their clients had become more engaged.

The report found that across the range of benefits, users believed their clients most valued:

- transparency (64%);
- diversification (59%);
- access to listed investments (49%);
- access to professional managers (49%); and
- cost effectiveness (47%).

Rapid adoption

Another key research finding was the rapid adoption rate of managed accounts by advisers.

Among current users, on average, managed accounts already comprise 33 per cent of their total FUA. These advisers expect their usage to increase to 51 per cent in three years' time.

Interestingly, the growth of managed accounts has taken off most rapidly with younger advisers (18-34 year olds), with 37 per cent of them actively using managed accounts. This age group is followed closely by those aged 35-44 years, with 35 per cent of them using managed accounts.

Of the advisers recommending or intending to recommend managed accounts, 50 per cent say these solutions help free up their time, while 45 per cent say it is the most effective way of implementing model portfolios.

Time savings

The report also highlighted the efficiency gains in administration by using managed accounts. The average managed account user estimated a time savings of 12.4 hours per week on portfolio management tasks.

The main time savings for advisers who use managed accounts were:

Investment administration work	105 minutes saved per week
Selecting/researching investments	97 minutes per week
Preparing ROAs	93 minutes per week

"We find that because advisers can save time on things like administration, they have more time to spend on higher value add tasks, like deepening the client relationship and expanding the provision of advice," said Geoff Rogers, General Manager, NAB Wealth Distribution.

DROP IN RETIREE SPENDING FASTER THAN EXPECTED

The rate of spending by retirees dramatically decreases as they age, more so than widely accepted, suggesting that existing retirement spending models need to be reappraised, according to the latest analysis from actuarial research firm, Milliman.

According to the Milliman Retirement Expectations and Spending Profiles (ESP) report, an average retired couple's expenditure falls by more than one-third (36.7 per cent) as they move from their peak spending years in early retirement (65-69 years) and into older age (85 years and over).

These findings are in contrast to the Association of Superannuation Funds of Australia (ASFA), which estimates that a 'comfortable' couple aged 85+ will spend 7.8 per cent

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less than those aged 65-85.

However, Milliman's analysis of over 300,000 Australian retirees found the spending for couples was relatively stable in the early years of retirement, starting at age 65 and then dropping by 6-8 per cent every four years, and then rapidly decreasing after age 80.

The research also found that:

- the food expenditure of retirees declines steeply with age;
- health spending increases with age but dips again after age 80; and
- discretionary spending, like travel and leisure, steadily declines throughout retirement.

The results of these findings imply that retirees who hold money back for future years, may never spend it. The research also undermines common practises, such as linking pension products to a rising consumer price index, as well as industry assumptions, such as the 70 per cent replacement ratio for retirement income.

According to Milliman, the faster-than-expected drop-off in spending by retirees casts doubt on some common industry perceptions, such as aiming to save enough superannuation to replace a set percentage of pre-retirement income.

The analysis suggests that retirement planning strategies may need to be re-examinded, particularly for many retirees who opt to take their super as an allocated pension and then draw down the minimum income, thereby under-spending during the early years of retirement when they are most active.

MANAGED ACCOUNT FUM UP 19%

The growth in managed account funds continues unabated, with funds under management (FUM) now standing at $57.05 billion – an 18.9 per cent increase in the six months to 31 December 2017. And for the 12 months 'year on year' period, this represents an annual growth rate of 45 per cent or $17.87 billion.

Wade Matterson

Commenting on the findings, the Institute of Managed Account Professionals (IMAP) Chair Toby Potter said $1.7 billion of this increase had come from companies that had been added to the six-monthly IMAP/Milliman Managed Accounts FUM Census, but over half of the increase was organic growth.

"This is because advisers are increasingly viewing managed account services as their preferred service model for a certain client segment," Potter said.

The Managed Account FUM Census is a bi-annual study of the FUM invested through the main forms of managed accounts, including SMA, MDA and IDPS-like services. The survey is conducted by IMAP in conjunction with global actuarial firm, Milliman.

In addressing the results, Milliman (Australia) practice leader, Wade Matterson estimated that 41 per cent ($4 billion) of the FUM increase could be attributed to very buoyant investment markets, with the value of the ASX/S&P 200 Accumulation Index increasing by 8.37 per cent over the six-month period.

"This compares with a 1 per cent or $0.39 billion market growth factor in the previous six months," Matterson said.

Potter believed that $3.37 billion of the increase in FUM was due to inflows of new funds from existing participants growing their managed account business, compared with $4.4 billion in the previous six-month period.

"This gives us a total figure for the past 12 months of $7.88 billion in new fund inflows for 2017," Potter said.

A total of 42 companies participated in the December 2017 Managed Accounts FUM Census, ranging from the very large players (major platforms and banks) and MDA providers, to individual licensees that mostly operate their service internally.

IMAP/Milliman Managed Accounts FUM Census - 31 December 2017

Managed Account category	31 Dec 2017 ($ billions)	30 June 2017 ($ billions)	Increase/Decrease ($ billions) Jun to Dec 2017	Increase/Decrease (%) Jun to Dec 2017
SMA/MIS	$17.04	$13.90	$3.14	22.59%
MDA services	$25.47	$23.37	$2.10	8.09%
Other services	$14.54	$10.70	$3.84	35.88%
Total	**$57.05**	**$47.97**	**$9.08**	**18.93%**

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ASIC RELEASES INDICATIVE LEVIES FOR 2017-18

New funding arrangements for ASIC came into law on 1 July 2017, with all organisations regulated by ASIC required to contribute towards the regulator's costs incurred in the previous financial year.

Some organisations will be required to pay a flat levy, with the cost of regulating a subsector shared equally among the entities operating in that subsector, while others will pay a graduated levy, with the entity's size or level of business activity determining their share of costs.

The indicative levies currently used by ASIC are estimates only, and the amounts are likely to change when ASIC's actual regulatory costs are known in November this year.

For example, in the 'investment management, superannuation and related services sector', ASIC's current indicative levies for 2017-18 are outlined in Table 1.

Table 1

Subsector	Levy metric and description	Indicative minimum levy/flat levy	Indicative graduated levy
Responsible entities	Adjusted total assets	$7,000	$10m threshold. Data not available to estimate indicative levy.
Investor directed portfolio service (IDPS) operators	Revenue from IDPS activity	$10,000	No threshold. Data not available to estimate indicative levy.
MDA providers	Flat levy	$1,346	n/a

Note that between July and September 2018, all organisations that ASIC regulates must log on to a new online ASIC portal to submit or validate their business activity metrics.

In June, ASIC will send a letter to the person listed as its contact for each organisation. This letter will contain a unique security key for the portal and detailed information on the process.

ASIC will use the information in these submissions to calculate final invoices, and in future years, generate estimated levy amounts for the entire regulated population.

ASIC will publish its actual regulatory costs in November, along with population and business activity metric data provided by the industry, which will enable entities to better estimate their individual levy.

This data requirement will enable ASIC to calculate each entity's share of the 2017-18 regulatory costs. Final invoices for the 2017-18 financial year will be issued by ASIC in January 2019.

Personal Advice Model

The final model for licensees providing tier 1 personal financial advice (section 43) includes a fixed levy component plus a graduated levy component using the following formula:

Minimum levy component + graduated levy component

The minimum levy component is $1,500. You must add to this amount the graduated levy component based on the following formula:

$$\left[\text{ASIC's sub-sector regulatory costs} - \left(\text{Minimum levy component of \$1500 x number of licensees}\right)\right] \times \left[\frac{\text{(No of advisers of licensee x number of days tier 1 personal advice licence authorisation held)}}{\text{(total no of advisers on FAR x 365 days)}}\right]$$

Other levies may apply for financial planners

The application of each levy is determined by the authorisations held on your licence and the definition of each section within the regulations. Hence, in addition to the personal advice levy, you may also incur the following levies:

- Insurance product distributor – will capture those authorised to 'deal' in general insurance, life risk insurance products or investment life insurance products (section 70);

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- Securities dealer – will capture those licensed to 'deal' in securities, with more than $250,000 in transactions executed on, or reported to, a large securities exchange in the financial year (section 67);
- MDA – will capture those who provide MDAs, including limited MDA services (section 32).

Other advice levies

If you do not provide tier 1 personal advice, or if you change your advice authorisation during the financial year, you may fall into the following advice levy sub-sectors:

- Licensees that provide only general advice to retail or wholesale clients (section 40);
- Licensees that provide personal advice to only wholesale clients (section 41);
- Licensees that provide personal advice to retail clients on only products that are not relevant financial products (i.e. basic products – section 42).

MANAGED ACCOUNTS AWARDS

Nominations for the inaugural IMAP Managed Account Awards are now closed. This year's awards will be judged across three categories:

1. Asset Class portfolios, comprising:

- Australian equities – ASX listed direct securities including Australian equities ETFs and associated securities;
- Australian equities small cap – ASX listed direct securities ex ASX 50;
- International equities – Directly held international securities, ASX listed ETFs and managed funds with ex AUS asset allocation;
- Multi-asset class – Multi-asset class portfolios with a designated objective, either risk profile based, absolute return or goals based objective;
- Other asset classes – Portfolios based on other investment objectives

2. Single AFSL/Dealer Group portfolios

Portfolios developed for representatives of a single AFSL.

3. Innovation

This category recognises a development in the area of managed accounts the judges believe improves the sector.

Judging criteria

In terms of the judging criteria for these awards, the portfolio needs to be offered through a managed account structure with the following features:

- Recognised legal structure – registered MIS, MDA, IDPS Like, IDPS model.
- Investments directly held by or on behalf of each investor.
- Model based.
- Clear discretion held by the portfolio or investment manager.

Importantly, the portfolio needs to have a clear objective and a benchmark.

For the Asset Class portfolios, judging will take into account:

- Performance over time periods of one and three years;
- Risk measures, including standard deviation and Sharpe ratio;
- Weighted average cost of investment, both directly and considering the underlying investments; and
- Qualitative criteria, including the resources available to the portfolio management organisation and the structure.

For the Single AFSL/Dealer Group portfolios, the criteria applied to single sector portfolios will apply, and in addition, the judges will also consider:

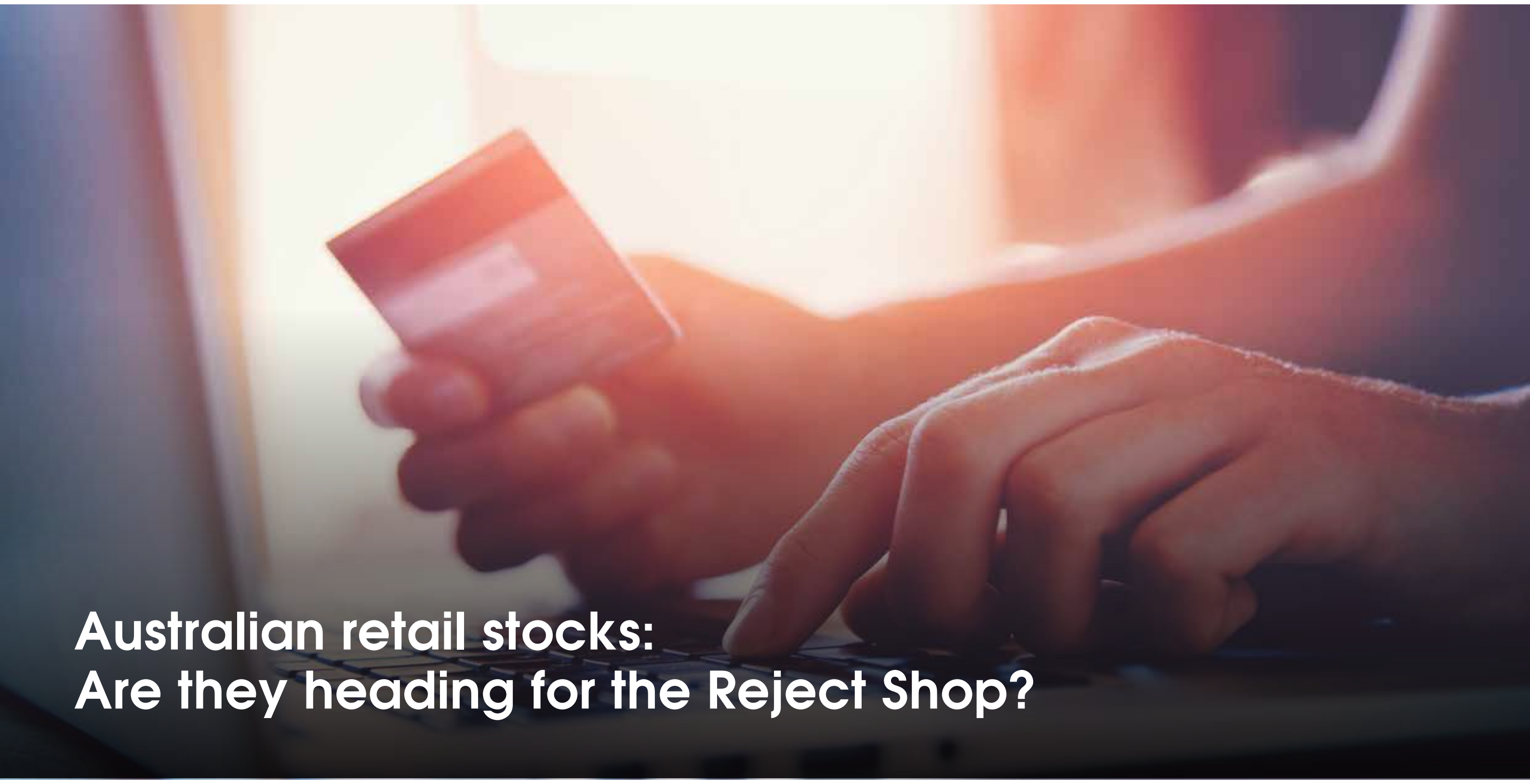
- The investment committee structure and resourcing;
- The way in which the portfolios reflect the advice firm's investment philosophy and appear to be integrated with it;
- How the managed account service fits with the client proposition; and
- Supporting materials, like communications about portfolio management and portfolio changes.

The Innovation Award is a broad category, which recognises those activities that have been designed to improve the:

- Operation and process of managed accounts;
- Adoption by advisers and licensees;
- Investment options; or
- Technology used to support managed accounts.

The IMAP Managed Accounts Awards will precede the IMAP Portfolio Management conference, and be presented in Sydney on 1 August at Dockside, Darling Harbour.

To register to attend the awards night, go to: www.imap.asn.au/imap-awards



Australian retail stocks: Are they heading for the Reject Shop?

Andrew Stanley

Amazon's arrival in the Australian market has generated intense speculation about the outlook for incumbent players. And while Amazon will undoubtedly take some retail share, research from Ralton Asset Management suggests the major impact of Amazon will be to accelerate fundamental changes in the ways companies interact with their customers.

This was the key takeout from Ralton Asset Management, Head of Australian Equities, Andrew Stanley, speaking at the IMAP Investment Forum on 13 April.

Stanley said Amazon is already affecting Australian retailers by:

- increasing price transparency;
- decreasing service costs for businesses;
- increasing direct competition; and
- enhancing the overall customer experience.

"We are seeing change coming from a shift in the way customers are shopping now," Stanley said. "They're moving away from traditional high street shops to online, so these 'bricks and mortar' stores will need to restructure their value proposition and adapt to new retailing trends."

Although Amazon had only captured 2 per cent of retail sales in Australia since entering the market last year, Stanley believed a structural shift was happening in the Australian retail sector.

"As Amazon continues to innovate, we will see retailers respond. We're already seeing this with price transparency, which will increasingly become the norm."

Stanley explained Ralton's framework for analysing how a business was adapting to the new retail environment, which included:

1. Management capability;
2. Price transparency;
3. Logistics;
4. Route to market;
5. Data analytics;
6. Customer service;
7. Capex and working capital; and
8. Talent acquisition.

"Amazon will accelerate the pace of change in the market," Stanley said. "There will be retailers that will thrive with this new competitive dynamic, like JB Hi-Fi, while others will struggle and disappear."

However, he added that Amazon's entry into the

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Australian marketplace wasn't without its own challenges and risks for the online giant.

These risks included: substantial logistics challenges, due to the geographical size of Australia and its limited distribution points; the response of competitors to the Amazon threat; potential anti-competitive behaviour; and a possible political backlash if the Amazon model forces too many businesses to close.

A decade of managed accounts

Also speaking at the IMAP Investment Forum was the managing director of Paradigm Wealth Management, Patrick Nalty CFP®.

Paradigm is a wealth management business with over 10 years' experience in using MDA services for its clients. Nalty provided insights in how the business delivered advice through MDA services, which has been one of the cornerstones in developing a broad suite of capabilities in advice and portfolio management for the Melbourne-based business.

Patrick Nalty

With six advisers and 12 support staff, Paradigm services about 450 clients, with 80 per cent of clients using a managed accounts solution.

Nalty advised any planning practice considering rolling out a managed accounts service to first take a solid look at their business and how they want it to look moving forward. He said this included considering three key processes. They are:

- the investment process;
- the communications process; and
- the transition process.

"Managed accounts bring a lot of tightness into your processes. The efficiency gains are massive but it's not an easy process to undertake, so you need to take the time to get all your processes in place." – Patrick Nalty

"Firstly, if you go down the managed accounts route, you need to realise you are becoming the investment manager. That means appointing an investment committee, whether internally or externally. We have an independent investment committee that take a macro view for our five model portfolios.

"And as part of the investment process, you need to closely engage with your PI insurer, to make sure they understand and feel comfortable about what you are doing."

Secondly, Nalty added that the communications process was very important when tailoring solutions for clients. He said Paradigm was currently looking to appoint a dedicated communications person, who would be responsible for providing discreet communication with clients when there are changes to a client's portfolio.

"When it comes to communicating with our clients, we're working towards 'push notification' through technologies like Smartphones and iPads," Nalty said.

And thirdly, Nalty advised that in the transition process to a managed accounts offering, businesses needed to carefully consider what providers to partner with.

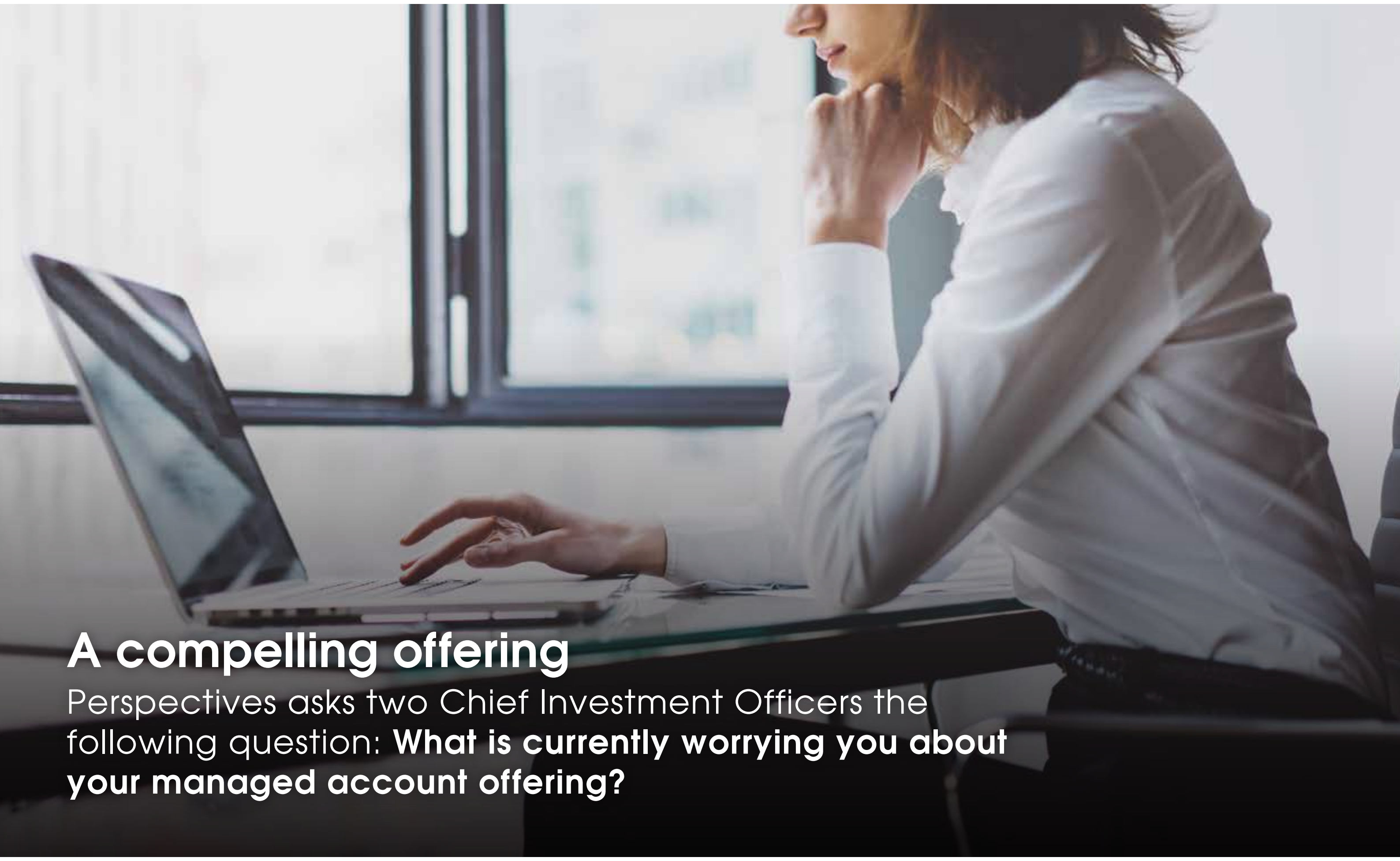
"Take your time in finding the right provider for your business and make sure they are investing in their technology and capabilities," he said.

"Managed accounts bring a lot of tightness into your processes. The efficiency gains are massive but it's not an easy process to undertake, so you need to take the time to get all your processes in place."

To read more of Patrick Nalty's insights on managed accounts, go to p16.

The next IMAP Investment Forum is scheduled for 31 August.

The IMAP Investment Forum is a community of interest for dealer group researchers, investment teams and independent researchers, where they can hear and learn from specialist portfolio managers and chief investment officers of advisory businesses. These experts and advisory professionals provide their insights on the practical issues involved in implementing managed accounts in an advice business.



A compelling offering

Perspectives asks two Chief Investment Officers the following question: **What is currently worrying you about your managed account offering?**

JONATHAN BAYES

Chief Investment Officer, Prime

> ...though we fear the downside more as the year draws on, the nearer term remains hard to call.
> – Jonathan Bayes

To be very honest, we are reasonably comfortable with our managed account offering. Prime manage four strategies: Aussie equity, international equity, diversified income and defensive income.

Within the constraints of our SMAs, we have the ability to raise cash as high as 15 per cent and to hold managed funds alongside listed equities, which means that as we have tactically grown more cautious on 'growth' assets during Q1, we were able to raise cash and to shift some of our 'beta' bets into strategies seeking absolute returns.

The outlook for markets is less clear, and though we fear the downside more as the year draws on, the nearer term remains hard to call.

We don't like the liquidity withdrawal going on at the Fed, but we acknowledge that the global and local economy are good and equity valuations are near two year lows.

Our thoughts are more towards the idea that the upside is increasingly capped, but we don't really know when the downside plays out, even though the risks are rising. This is why we are shifting our biases where possible to absolute return funds within the 'growth' component of our asset base.

Strategically, where we and many advice firms struggle on the asset allocation piece with SMAs is still in the alternatives space.

Though it's not a large part of our asset allocation, it is still relevant, and so we are yet to determine how or if we will offer an SMA exposure to commodity-trading-advisor (CTA) funds, commodity or even unlisted property and infrastructure funds. So in that respect, we are mulling things over.

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GRAYDEN TAYLOR
**Portfolio Manager,
Elston Asset Management**

> As an industry, we must continue to educate both advisers and investors on why managed accounts make sense, and clearly articulate to advisers how using managed accounts is going to help their clients.
> – Grayden Taylor

As a long-term provider of both Individually Managed Accounts (IMAs) and Separately Managed Accounts (SMAs) solutions, it has been easy to get frustrated by the pace of take up within the wider adviser community, compared to less customised offerings available.

As an industry, we must continue to educate both advisers and investors on why managed accounts make sense, and clearly articulate to advisers how using managed accounts is going to help their clients.

One of the key advantages is the ability to manage portfolios based on the investor's individual tax circumstances. This enables the value, which advisers provide through their strategic advice, to be enhanced by the 'tax-alpha' generated by the managed account portfolio manager through deferring or limiting tax, leaving the client better off on an after-tax basis.

Where advice businesses are making the switch from unitised vehicles to managed accounts, the preferred option to date has been to use platform SMAs as a stepping stone. Given that a focus on after-tax management is a core philosophy at Elston Asset Management, this is undoubtedly viewed as a step in the right direction.

That said, despite steadily improving functionality from platform providers in recent years, the degree of flexibility does vary between providers and does not yet match that available from IMAs, which can be frustrating for a portfolio manager trying to maximise the client's after-tax outcome.

No doubt, a combination of adviser demand, platform provider investment and general technology advancements will see platform SMA functionality improve further, so that advisers and investors alike can benefit fully from these compelling solutions.

Would you like to join our panel of managed account professionals willing to share their opinion on various topical issues? If so, we want to hear from you!

Email jaysonjforrest@gmail.com to register your interest.

Transform your advice business

Peter Chun looks at the three main reasons managed accounts are increasingly being adopted within advice businesses.

PETER CHUN
General Manager Distribution,
Colonial First State

One of the questions I get asked frequently is why managed accounts have skyrocketed in popularity over the last few years. And while sometimes it can be difficult to pinpoint why certain investment solutions suddenly gain traction, in the case of managed accounts, I think it's quite clear.

The investment benefits managed accounts offer clients have been key drivers behind the growing interest in them and are generally well understood. Depending on the structure of the managed account, these can include transparency of underlying assets within the portfolio, beneficial ownership for clients over the underlying assets and individual tax outcomes.

> "I'm seeing advice businesses enjoying great efficiency gains by using managed accounts to outsource portfolio management to a professional portfolio manager."

In addition to the client benefits, based on my conversations with advisers and licensees, I think there are three main reasons managed accounts are increasingly being adopted within advice businesses:

- greater administration efficiency and risk controls;
- better client engagement; and
- improved business performance.

1. Increased efficiency and better risk controls

Most advisers still spend much more time on administration than they spend face-to-face with their clients. The beauty of managed accounts is they can help switch this ratio around.

I'm seeing advice businesses enjoying great efficiency gains by using managed accounts to outsource portfolio management to a professional portfolio manager. They're effectively handing over the responsibility for investment selection, rebalancing, corporate actions and trade execution – along with the countless administrative requirements related to these investment activities.

And the portfolio manager also manages the level of risk within the portfolio and makes adjustments in response to market conditions. This allows advisers to focus on providing strategic advice, knowing their clients' portfolios are being managed by experts.

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> As well as the positive impact managed accounts can have on the efficiency, risk controls and client engagement within an advice business, they can also help drive profitability.

To validate what we've been hearing from the market, Colonial First State (CFS) recently commissioned a survey by Business Health and IMAP on the benefits of managed accounts to advice practices, and the results are compelling.

According to key findings from the survey, 87 per cent of advisers reported that using managed accounts has reduced the time they spend on administration, and 70 per cent reported improved risk controls as a result of moving to managed accounts.

2. Better client engagement

The cumulative effect of greater efficiency and reduced risk is that the advice businesses in our research group have been able to spend more time developing strategic advice for their clients. Seventy-three per cent of practices using managed accounts identified improved client engagement as a benefit, which is important, as other Business Health surveys show improved client engagement leads to more satisfied clients and higher client retention.

Growing and maintaining a profitable and well-run business can be a full-time job in itself, but ultimately, it's the clients who ensure a business's success. By focusing on client needs and outcomes, rather than administration, everyone benefits.

3. Improved business performance

As well as the positive impact managed accounts can have on the efficiency, risk controls and client engagement within an advice business, they can also help drive profitability.

This was highlighted in our research, with practices using managed accounts reporting on average a 25 per cent higher profitability than those that weren't using them.

And the news is even better for practices that embed managed accounts into their business model. Practices with over 50 per cent of their clients invested in managed accounts reported over double the profits of those that had less than 50 per cent invested.

Managed account solutions

Providing advisers and licensees with efficient portfolio management solutions is at the heart of what we do at CFS. For us, managed accounts are simply the next step in this evolution.

It's not well-known, but we have a strong history in managed accounts dating back to 2008. We started our journey 10 years ago by developing customised managed account solutions for a small number of our large institutional clients and we currently administer over $7 billion in FUA within these structures.

In developing our managed accounts product suite, we recognise that different licensees and advisers have individual business needs and requirements. That's why, rather than developing a one-size-fits-all solution, our approach is to develop a range of managed account solutions.

We currently offer managed accounts solutions on both our FirstChoice and FirstWrap platforms. Work is also underway on our FirstWrap tailored managed account solution, which will complement the existing FirstChoice offering. These services are ideally suited to licensees with in-house investment capability that are looking to take on the role of portfolio manager for their managed accounts solution.

No matter what type of managed accounts solution you choose, it will likely take time to implement within your business and to educate both your clients and staff. That's where the team at CFS can help.

To learn more about managed accounts or the managed account solutions at CFS, visit colonialfirststate.com.au/managedaccounts.

Peter Chun is General Manager Distribution at Colonial First State.

2018 IMAP Portfolio Management Conference

Implementing managed accounts into an advisory practice, as well as asset allocation and portfolio construction, will all be discussed at the upcoming 2018 IMAP Portfolio Management Conference on 2 August at Dockside Convention Centre, Sydney.

For more information, go to: www.imap.asn.au

The three pillars of MDAs

As an early adopter of managed accounts, Patrick Nalty believes that the MDA environment has provided positive outcomes for his clients and his business, but admits it's a journey not suited to all planning businesses. He talks to Jayson Forrest.

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Patrick Nalty CFP® first dipped his toe into the world of managed accounts eight years ago, seven years after he founded the Paradigm Group with James Mirams. Back then, Patrick knew there had to be a better way to provide a tailored solution to the investment needs of clients – a solution that was designed to support a proactive investment approach designed to deliver a better client experience, whilst also delivering administrative efficiencies to the business.

The answer was managed accounts.

Today, Patrick and James retain ownership of the privately owned boutique financial services business based in Melbourne, with Patrick maintaining a hands-on approach in its daily operation as managing director of Paradigm.

He proudly sees the business as being an early innovator in the use of "next-generation" MDA technology to deliver clients with the advantages of direct investment ownership, combined with the benefits of professional and proactive investment management.

"When we set up our MDA offering eight years ago, we were the early adopters. We knew then, as we know now, there had to be a better way of managing client portfolios," Patrick says.

"Back then, we were faced with two problems. Prior to the GFC, we were concerned that markets were peaking but in order to change any of our clients' investments, we had to either do an SOA or an ROA and get the client's approval to change the investments.

"So, if we wanted to shorten our position in Australian equities, we had to get the client's approval to do that. But a lot of our clients were semi-retired and travelled a lot, which made it difficult to contact them. In addition, given we have always been passionate about the benefit to clients of the direct ownership of assets, it was a hugely onerous task to work through your entire client base in order to get the proper authorisations to change a client's investments."

Another issue that steered Paradigm down the managed accounts path was the complexity, time limitations and manual input that came with managing the investments of clients.

"As we were doing direct equities, fixed interest and listed property, if we had a corporate action, we would receive voluminous amounts of mail that were full of PDS's on the corporate action. It was a very cumbersome way of managing our clients' affairs, and also increased the possibility that clients were not available or could not respond in the timeframe required," he says.

> "For anybody contemplating running a managed account offering, you've got to make sure you're running a strict compliance regime."

"So, we thought there had to be a better way of doing things to ensure the actions required to achieve the best interests of clients could be carried out efficiently. After a lot of research, we realised that the MDA environment, where clients provide discretion for the management of their investment portfolios, was the right way to go."

Three pillars of implementation

Eight years on, Patrick doesn't regret being "a little bit smarter" by moving his business into the MDA environment, but admits it's a journey not suited to all planning businesses.

"Managed accounts deliver a lot of tightness to your processes," he says. "The efficiency gains are considerable but it's not an easy process to undertake. You really need to take a solid look at your clients and your business, and work out what clients will benefit most, and how you're going to transition the appropriate clients to the MDA service."

Before rolling out a managed account service, Patrick recommends businesses carefully consider, what he believes to be, the three pillars in the implementation process of a managed account offering. They are:

- the investment process;
- the communications process; and
- the transition process.

1. Investment process

According to Patrick, by going down the managed account path, a planning business is effectively becoming the investment manager, which means having to formulate an investment committee, whether internally or externally, for the investment decisions.

"We wanted to operate in a way that was similar to a mini-industry fund," Patrick says. "So, we have an administrator in our managed account provider and we have an independent investment committee that takes

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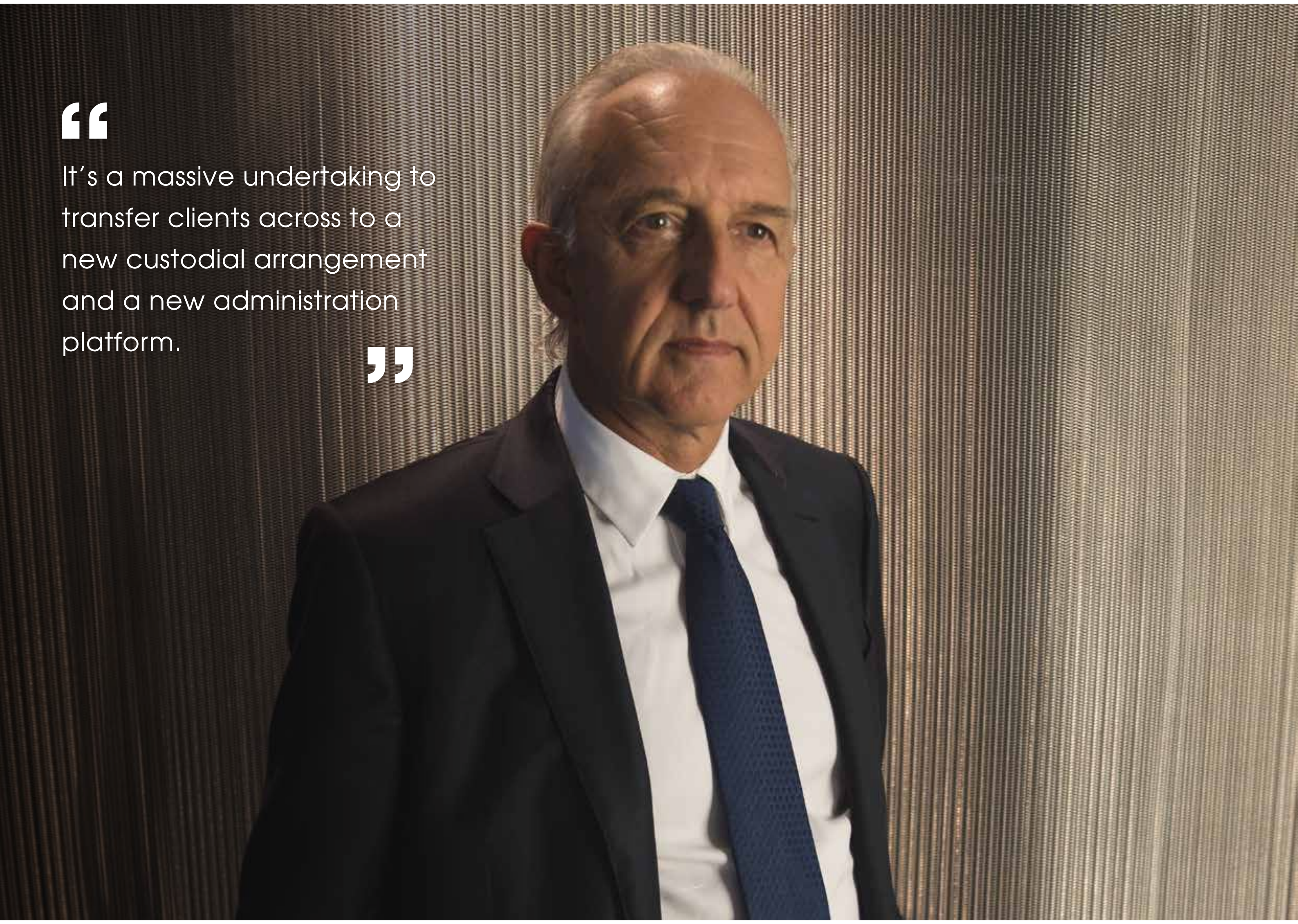

a macro economic view and determines strategic and tactical asset allocations appropriate to the various risk profiles that apply across the client base. The investment committee is also responsible for appointing ‘best of breed’ asset class specialists under strict criteria and controls, to run our asset class based mandated model portfolios.”

Patrick says clients remain very engaged in the investment process because they retain beneficial ownership of their assets and have full and transparent view of the portfolio activity, including purchases, sales and corporate actions. But he adds the overall investment process remains externally managed by asset class specialists whose role it is to manage that specific asset class in the very best interest of clients through the mandate provided to them by the Paradigm investment committee.

“By adopting this approach, Paradigm as a business can fundamentally focus on the client relationships and we mitigate any perceived conflicts of interest because the investment management process is actually outsourced to individual specialist managers.”

He also adds that as part of the investment process, businesses need to engage closely with their PI insurer, to make sure the insurer understands and feels comfortable about what the business is doing.

2. Communication process

Secondly, Patrick adds that the communications process is very important when implementing a managed account service and for providing ongoing tailored solutions for clients.

He concedes that Paradigm did initially have reservations about seeking client discretion over their portfolios, but as clients already trusted the business, this actually didn’t prove to be a problem.

“There absolutely needs to be a degree of trust by clients to go into managed accounts,” Patrick says. “However, even

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> Take your time in finding the right provider for your business and make sure they are investing in their technology and capabilities.

with this trust, it was still a lot of hard work to transition over. A lot of clients were in individual HINs (holder identification numbers), so we had to transfer them all over. We had to do a lot of hard work transferring, redeeming and restructuring the existing investments and moving them to the new custody arrangement and the new individual managers."

Patrick firmly believes the trick to making any new business endeavour successful is clear communication and lots of it. Interestingly, Paradigm is currently looking to appoint a dedicated communications person, who will be responsible for providing "discreet" communication with clients when there are changes to their portfolios.

"When it comes to communicating with our clients, we're working towards 'push notification' through devices like smartphones," Patrick says. "Technological innovation is becoming increasingly important, and will enable us to interact much more efficiently with our clients in a real-time environment."

3. Transition process

When implementing a managed accounts strategy, Patrick says businesses need to carefully consider what providers to partner with.

"Take your time in finding the right provider for your business and make sure they are investing in their technology and capabilities," he says.

In terms of technology choice, Paradigm currently uses XPlan as its lead CRM, Class for its SMSF administration, and managedaccounts.com.au for driving Paradigm's MDA technology.

However, he concedes that the business is currently reviewing its technology providers.

"Since we got into managed accounts eight years ago, there's been a significant investment by providers in technology. Managed accounts is very much a technology play, so we're in discussions with a number of providers about their offering and the advancements they've made in technology over the last couple of years."

As an example, Patrick is looking for technology that will automatically rebalance portfolios when investment managers make decisions or companies initiate a corporate action.

"Managed accounts bring a lot of tightness into your processes. The efficiency gains are significant but it's not an easy process to undertake, so you need to take the time to get all your processes in place," he says.

Paradigm Managed Account Service

Today, Paradigm manages approximately $300 million in its managed account service, with the average client balance size being $1.2 million.

"Paradigm has a couple of hundred million dollars worth of funds under management spread across other platforms not in the MDA," Patrick says.

"Our preferred minimum investment into the managed account is $500,000. We're not trying to be all things to all people. Clients who we deem not to be financially sophisticated or savvy, and may not be comfortable with direct investments, are catered for in the retail environment via a wrap account."

Patrick adds that Paradigm is currently investigating implementing a retail MDA offering, which will sit under one of the managed account providers' IDPS services. This structure will provide a low cost solution using investments such as ETFs and LICs.

"Because Paradigm has become very good at managing clients' money, we find that we're attracting clients who have substantially greater wealth. They like the way we run our portfolios with our specialist managers and investment committee. So, it's working out quite well."

The Paradigm Managed Account Service (PMAS) is an investment portfolio service that provides its clients with choice and flexibility without the ongoing administrative burden.

Clients can invest across a range of asset class based model portfolios – all managed by specialist investment managers. These include: Australian shares, international shares, listed property, fixed interest and alternative assets. In addition, clients can benefit from a separate model called the Transition Portfolio.

"The Transition Portfolio is used by clients as a 'holding' portfolio, for example, for shares that may have been bequeathed to them that fall outside their portfolios that they wish to retain or where activity may be constricted by significant capital gains implications," Patrick says.

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> Managed accounts bring a lot of tightness into your processes. The efficiency gains are significant but it's not an easy process to undertake, so you need to take the time to get all your processes in place.

He adds the PMAS is open to individual investors, corporate clients, family trusts, self-managed superannuation funds, charities and endowment funds. While most investors in the PMAS also receive financial advice from Paradigm, the service is available for those who just want to invest without advice.

Looking back, looking forward

So, what changes does Patrick anticipate over the next 5-10 years to Paradigm's service offering?

Firstly, he doesn't rule out the acquisition of advisers and practices that might enhance the business's capabilities.

"The compliance side of managing portfolios and clients' investments is getting quite tricky. There are a number of smaller practices we're currently talking to in regards to either acquiring or partially acquiring. By doing so, we can provide their clients with a more sophisticated and robust investment approach, whilst providing those practices with significant efficiencies by adopting an MDA within their business," Patrick says.

"It's a very efficient way of managing portfolios if you do what Paradigm has done, like outsource the administration, outsource the investment committee and outsource the mandates."

And as Paradigm grows, he suggests that the business will probably have to appoint a full-time person to look after the compliance side of the business; to maintain the strong compliance culture across a broader organisational structure.

"I think compliance is a big issue going forward. For anybody contemplating running a managed account offering, you've got to make sure you're running a strict compliance regime. That includes knowing how to manage any conflicts of interest and knowing how to manage your portfolios in a professional manner."

But it's technological innovation that Patrick sees as being the real definer for businesses moving forward.

"You'll need technology that's going to be able to talk to an app to enable clients to track their investment portfolios. Research shows that people searching for information today are increasingly moving away from their iPads and computers, and are using their smartphones instead.

"So, everything we'll be doing going forward will be based on using technology to its best advantage, enabling us to engage with clients efficiently."

And what about professional alliances?

He views accountants as being a real opportunity for the business.

"For wealthier clients, we see the accountant as being their primary adviser. But accountants really don't have the ability to manage money very well; they don't either have the skills, the expertise or the licence to do that. So, we want to be in a position to work with accountants who want to provide their clients with a professional outcome on their investment management."

Worth the effort

With eight years under his belt offering clients a managed account service, what advice does Patrick have for any business looking at rolling out their own offering?

"Take the time to plan. It's a massive undertaking to transfer clients across to a new custodial arrangement and a new administration platform. So, my advice is to make sure you're working with a good provider that's got plenty of resources and the right investment philosophy to help you make the transition."

But does that mean scale is critical for any business wanting to roll out its own managed account service?

"Put it this way," Patrick says. "You can't do the work to transfer your clients into the new world without a fair bit of internal back-office grunt support from within your organisation. So, if you haven't got that, it's going to be problematic, unless you've got a provider that is willing to throw its resources to the task of transitioning."

But never underestimating the amount of hard work involved in moving to an MDA environment, Patrick looks back now and admits it's been worth all the pain and effort involved.

"I can honestly say, it's enhanced our clients' experience, and has made our business so much more efficient."

The building blocks of business

In March, the 2018 IMAP Adviser Roadshow reached over 420 industry professionals across three capital cities – Brisbane, Melbourne and Sydney. Jayson Forrest reviews some of the highlights of this year's roadshow, including in-depth reviews of three topical sessions.

BUILDING A PRIVATE LABEL

In officially opening this year's Adviser Roadshow, IMAP Chair Toby Potter revealed the current state of managed accounts in Australia, with funds under management (FUM) now standing at $57.05 billion – an 18.9 per cent increase in the six months to 31 December 2017. For the 12 months 'year on year' period, this represents an annual growth rate of 45 per cent or $17.87 billion.

This year's roadshow featured a range of industry experts and panel discussions, which highlighted various aspects of the managed accounts sector.

In a panel session titled, 'Building a Private Label', three industry professionals – Nick Mitchell (Netwealth), Lukasz de Pourbaix (Lonsec) and Jonathan Kilborn (Cardena Private Wealth) – shared their perspectives on how they built a private label.

According to Netwealth Head of Distribution, Nick Mitchell, Netwealth got into managed accounts about 3.5 years ago, when it identified the move by many IFAs to rapidly transition their businesses to include managed accounts.

"Managed accounts is a rapidly growing sector of the industry and we expect 57 per cent of advisers will look to incorporate managed accounts into their offering by 2019," Mitchell said, adding that managed accounts provided advisers with a "frictionless" client experience.

Mitchell believed there were a number of advantages for practices going down the private label path. They include:

- greater sophistication and customisation of service offering;

> "Managed accounts is a rapidly growing sector of the industry and we expect 57 per cent of advisers will look to incorporate managed accounts into their offering by 2019. - Nick Mitchell"

- access to broader asset classes, such as international equities, listed property, bonds and other fixed interest;
- model of models, enabling advisers to diversify manager risk and ensuring best of breed; and
- enhanced fee management and reporting.

Cardena Private Wealth is a non-institutionally owned, fee-for-service advice business based in Sydney. As a director of Cardena, Jonathan Kilborn said they started thinking about building a private label about three years ago. He admitted that the process of working out the business's beliefs and investment philosophy took some time.

"When building our private label, we worked with a consultant, who helped us with our investment committee and asset consultants," Kilborn said. "It's important to work with people who are also on the same page as you, particularly with things such as your investment philosophy."

Lonsec Chief Investment Officer, Lukasz de Pourbaix agreed that the investment philosophy was key to the success of any private label.

"Most advisers I speak to have an investment belief

Delegates enjoyed the networking opportunities at the 2018 IMAP Adviser Roadshow.

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Over 420 delegates across three cities enjoyed the opportunity to hear insights from managed account professionals.

> "Accountants are the gatekeepers. So, for our practice, it's about getting the gatekeeper over the line, as they are the trusted professional of HNW clients.
> – Richard Sheargold"

or philosophy. But they need to ensure that this belief or philosophy is properly documented, to ensure they remain true to it."

He added that with the increasing level of compliance and due diligence in the sector, a lot of education around managed accounts was still required for advisers and dealer groups.

When asked what advice he had for any practice looking at rolling out a private label offering, Kilborn advised to take the time to do it well.

"When you start this journey, you need to realise it takes time and cost to do well," he said. "And appoint a dedicated person, whether internally or externally, like a consultant, to undertake the due diligence and implement the strategy.

"And importantly, you need to remain reflective on your processes, which means asking yourself: Is this still the most efficient and cost-effective way of doing things."

Serving HNW clients

In another session titled, 'Serving HNW Clients – How Different Is It?', Richard Sheargold from Stonebridge Capital provided his thoughts on servicing high-net-worth (HNW) clients. He believed the key to working with HNW clients was working with their accountants, or as he termed, the "gatekeepers".

"The HNW clients referred to our practice primarily come from accountants," he said. "Accountants are the gatekeepers. So, for our practice, it's about getting the gatekeeper over the line, as they are the trusted professional of HNW clients."

Sheargold added that it was often a contentious issue with HNW clients having their investment portfolio discretionally managed.

"These clients like to be in control, so moving them to a discretionary environment does require convincing and trust. We do this by managing their expectations and ensuring that we have structured monthly communication with them."

Interestingly, Sheargold revealed that ultra HNW clients were drawn to ethical investing, and liked access to international equities and block trading.

He added: "When you have HNW clients you need to be aware that no one-size fits all. Different generations invest differently. This is particularly evident with generational wealth transfer."

Profitability in an advice practice

Terry Bell provides some quantitative metrics that measure the profitability of advisory practices offering a managed accounts solution.

As part of the Business Health HealthCheck, we asked principals how they saw the next 12 months – and it's generally an optimistic outlook. But there are challenges ahead for the industry, like disruption through technology and competitors, regulatory change, industry rationalisation, demographic change and evolving business models.

But despite these challenges, as outlined below, advice principals remain optimistic:

- 94% expect to increase their practice revenue;
- 89% expect to increase their revenue generated by fees;
- 80% expect to increase the number of clients they service;
- 61% will build on the number of third-party referral partners;
- 42% will recruit more income producers to their business; and
- 46% expect to appoint more support staff.

However, without an effective business plan in place, principals will struggle to face the challenges ahead. An effective business plan is the major driver of profit, and without a structured business plan in place, businesses will struggle to navigate the challenges.

For a plan to be effective, it needs to be:

- clearly documented, so the business can be held accountable to it;
- comprehensive;
- contain the following – 'who's' going to do 'what', by 'when' and 'how'; and
- quarterly monitoring of a 'progress to plan'.

Yet, Business Health data reveals that one in four practices (24 per cent) do not have a business plan in place, which is concerning.

But for those businesses that do have a business plan in place and are implementing it effectively, they are significantly more profitable – up to 209 per cent. This demonstrates that an effective business plan, which is

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implemented properly, will generate more profit for a business.

Managed accounts

So, how does the world of managed accounts look?

The HealthCheck data we have compiled for the managed accounts sector is based on 93 respondents and was run over the first three months of 2018 – January to March. The respondents comprise of a mix of businesses. This research was sponsored by Colonial First State.

The data shows that practices using managed accounts are seeing real benefits to their businesses. The top five benefits include:

- 87% – have seen a reduction in administration (i.e. no ROAs);
- 47% – more time spent with clients (i.e. face-to-face meetings);
- 73% – have experienced improved client engagement;
- 70% – have seen improved risk control; and
- 83% – have recorded improved client outcomes.

Table 1 compares managed account practices to mainstream advisory practices without a managed account offering.

Table 1

Dimension	All practices	Managed accounts
Gross practice revenue	$1.16m	$1.53m
No. of client appointments per planner/per week	6	7.4
Number of individual clients	715	614
FUM/FUA	$137m	$165m
Clients per planner	285	336
Number of full-time employees	5.6	6.1
Notional profitability	27%	34%

In compiling this data on managed accounts, it's crucial to note the importance of client communication in the advice process.

For example, one of our other tools at Business Health is a client survey. We confidentially ask clients on behalf of a practice, how they consider their adviser across

> "But for those businesses that do have a business plan in place and are implementing it effectively, they are significantly more profitable – up to 209 per cent."

a number of areas, including nine KPIs. After 15 years of doing this survey, 'communication' comes in as the bottom KPI across five countries (U.S., South Africa, U.K., Singapore and Australia).

As part of your business plan, it's vital that you look at your communication program. Look at the acronyms you use in the advice process, how you convey your messages, and how you actually talk to clients. And if you do have a communication program, make sure it is resonating with your clients? So, how do you do that? You simply ask them.

However, only 34 per cent of planning practices are currently seeking feedback from their clients, which means that two-thirds of practices have not sought feedback. So, a regularly reviewed communication program should be added to any business plan – in fact, it's critical for your notional profitability.

5 key takeouts

We have uncovered five key takeouts of our research into managed accounts. These are as follows:

1. Benefits accelerate as solutions embed.

Our research shows that those planners who have been offering managed accounts for more than three years are significantly more profitable than those planners who have been offering them for less than three years (Table 2).

Table 2

<table>
<tr><th colspan="2">Dimension</th><th>% Practices</th><th>Profit uplift</th></tr>
<tr><td rowspan="2">Length of time offering managed accounts</td><td><3 years</td><td>63%</td><td>-</td></tr>
<tr><td>>3 years</td><td>37%</td><td>+116%</td></tr>
<tr><td rowspan="2">% of clients invested in managed accounts</td><td><50%</td><td>70%</td><td>-</td></tr>
<tr><td>>50%</td><td>30%</td><td>+118%</td></tr>
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So, if you've begun the managed accounts journey, my advice is to continue that journey because there is payback at the end of the line. It makes sense, because managed accounts are a whole business solution.

And the second profit driver for businesses is the fact that clients become invested in the managed accounts solution. For example, those planning practices that offer managed accounts to more than half of their clients are more profitable.

So, the longer you're involved with managed accounts, the better you'll become with them. And the more embedded managed accounts become within your practice, the greater the profitability to your business.

2. Higher profitability.

A managed accounts offering is bringing businesses higher FUM, higher revenue and higher profit for principals. At Business Health, we calculate a $110,000 difference for principals running managed accounts versus those who don't (Table 3).

Table 3

Dimension	All practices	Managed accounts
Annual revenue	$1.16m	$1.53m
FUM	$137m	$165m
Profit/principal	$266,998	$380,998

So, managed account businesses are more profitable.

3. Communication is key to any relationship.

The key to any successful and longstanding relationship is clear and effective communication.

Businesses that contact their 'A' class clients 10 times a year or more, are making 31 per cent more profit than those that don't (Table 4).

Table 4

Dimension	All practices	Managed accounts
10+ 'A' client contacts per year	39%	47%
Quarterly+ 'A' client reviews	28%	37%
Appointments per week	6	7.4
97%+ 'A' client retention	44%	59%

"The longer you're involved with managed accounts, the better you'll become with them. And the more embedded managed accounts become within your practice, the greater the profitability to your business."

So, customised communication that is done meaningfully and frequently, produces a higher level of profit for practices. That's because clients actually think their planner is actively working for them, as they are regularly hearing from them.

4. Higher profitability for those who segment.

Client segmentation is alive and well in planning practices, and for those businesses that are unable to offer differentiated services, they will struggle to survive going forward.

Every client has to be treated with respect and fairly, but not necessarily equally. Eighty per cent of revenue is coming from 20 per cent of clients. So, client segmentation is a big issue. According to Business Health data, those businesses that are segmenting are significantly more profitable than those that aren't (Table 5).

Table 5

Dimension	All practices	Managed accounts
Average number of clients	715	614
Those that segment their clients	77%	90%

So, client segmentation does work and it's a big driver of profit. It frees up a practice's time and resources to work on those 'A' class clients from which the practice draws most of its revenue. And our data shows that 90 per cent of managed account businesses are segmenting their client base, compared to 77 per cent of all practices.

5. An even more valued service.

Eight-seven per cent of the marketplace charge a fee for the preparation of an SOA, whereas 97 per cent of managed account businesses charge a fee for preparing an SOA. Managed account businesses are more confident about charging explicit client fees (Table 6).

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Table 6

Dimension	All practices	Managed accounts
Charging for SOA	87%	97%
Charging for implementation	79%	83%
Service level agreements with 'A' clients	60%	63%
20+ new clients in past 12 months	48%	60%

Why are managed account practices more profitable?

There are three key reasons that help to explain why managed account practices are more profitable.

1. Efficiency: The Business Health data shows managed account practices to be more efficient. The key points being:

- With experience comes confidence;
- A reduction in administration time and costs;
- Improved risk control; and
- Managed accounts are integral to these businesses.

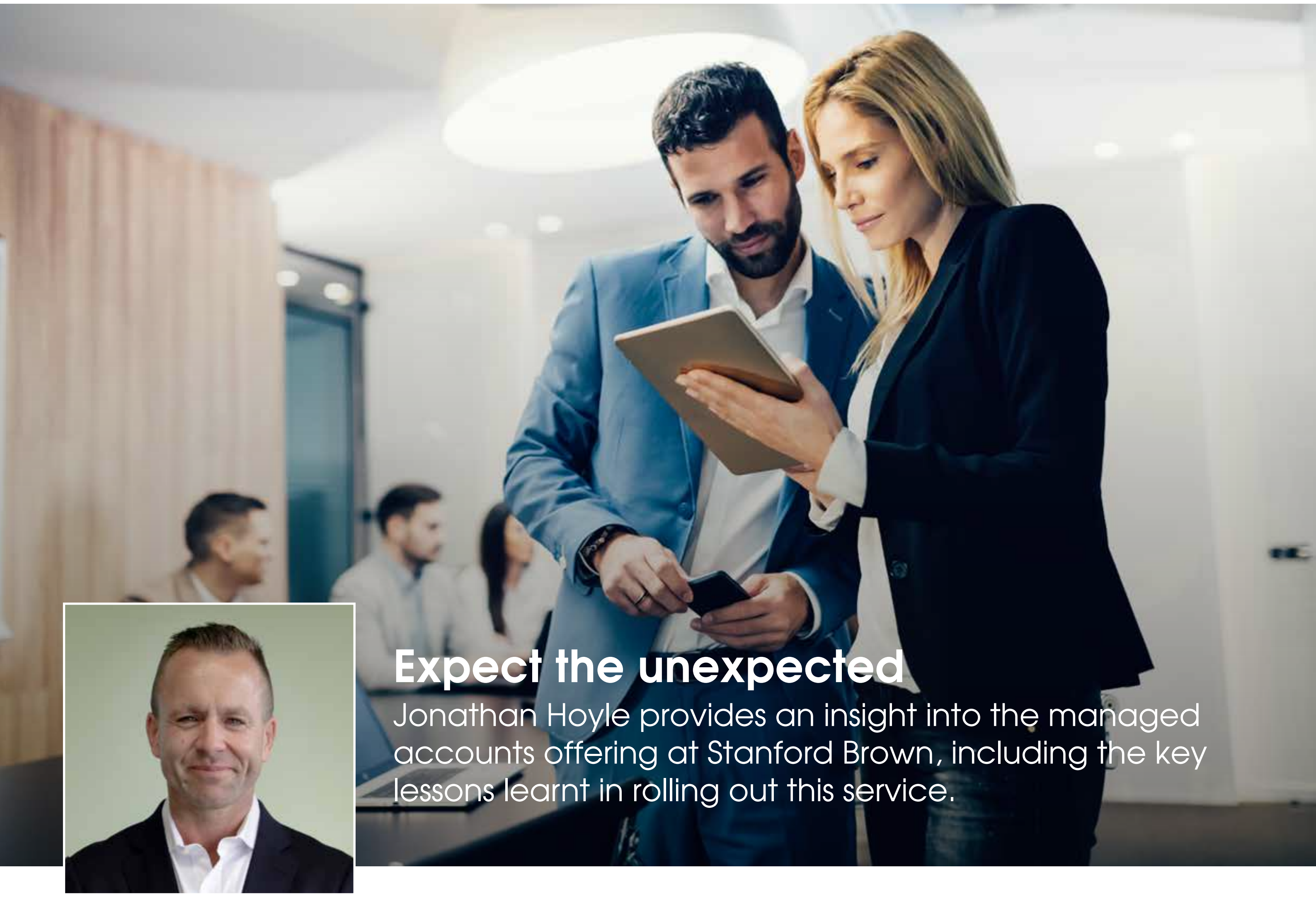
2. Confidence: Managed account businesses tend to be more confident. They charge more for their fees, they are confident in their offering, they have improved investment outcomes for their clients, their existing clientele are happy, and they have an expanded range of services.

3. More time: Managed account businesses have more time for clients. This includes more time put aside for face-to-face meetings, more client contact, more client reviews, and greater client segmentation.

These findings are Business Health's high level take on the data currently complied on the Australian managed accounts sector. It will be interesting to see how this data evolves over the coming years.

Terry Bell is a Partner of Business Health. For more information, go to businesshealth.com.au

The Business Health Managed Accounts research was sponsored by Colonial First State.



Expect the unexpected

Jonathan Hoyle provides an insight into the managed accounts offering at Stanford Brown, including the key lessons learnt in rolling out this service.

Stanford Brown's adoption of managed accounts has radically changed the way we service our clients. There were four key issues that prompted us to go down the managed accounts path. They were:

1. Speed: Our investment committee would meet monthly, we would make our decisions, we would communicate those decisions to our advisers and then they would roll those decisions out to clients, depending on when they would next meet them. As we typically see most of our clients twice or three times a year, that meant the wait could have been six months between making a decision and executing it. It was an old-fashioned and sluggish way of doing things.

So, speed was our number one concern that we wanted to address. We wanted to introduce a much more efficient way of rolling out investment committee decisions.

2. Administration: Our back-office was growing significantly. Trade errors were starting to come out and corporate actions were a nightmare. We had reached the ceiling of what we could administratively cope with.

3. Consistency: We were looking for a more consistent approach to how we managed portfolios and did business.

4. Client engagement: Our advisers had a close relationship with their clients. Typically, they got so wrapped up talking to their clients about particular stocks and funds that we realised it were the advisers who really cared the most about these stocks and funds, whereas our clients really didn't care. However, our advisers convinced themselves that their clients did care, only later discovering how little they really did care.

We realised that clients didn't come to us to discuss what the fund manager was putting their money into. They came to us because they didn't have enough time to invest their own money or they didn't have the necessary skill set to invest their own money. But for those that did, then we would advise them to get an SMSF and do the investing themselves.

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5 key benefits

Since implementing managed accounts into our business, the benefits have been enormous. The following are five of the key benefits to our business.

1. Proactive portfolio management

We had been long the Australian dollar last year. When the dollar hit $0.80, it looked like it had peaked. That's when we decided to go underweight Aussie dollar.

So, we executed that position. But, we didn't do it by options or derivatives, we did it using Vanguard ETFs.

We have a core satellite approach. We use more ETFs than active funds. But there are funds that do consistently add value over time, and with these funds, we give them 'lock-up' money. That is, we tell them that this is their money for, say, three years. We won't pull that money out for one bad year, but if they have three, then we will review things.

The 'satellite' are the tracker funds. Vanguard has two: it has an unhedged international share fund (VGS) and it has a hedged international share fund (VGAD). We just flip one for the other, so you can suddenly go from being overweight in the Aussie dollar, to being underweight.

This means you can flick a switch on your platform and suddenly all our 490 clients on the platform are now underweight the Aussie dollar. It's that quick, it's that effective.

2. Equitable distribution of fees

Introducing managed accounts into your business doesn't mean you're adding another layer of fees for the client. In fact, I'd say it's a more equitable distribution of those fees. We have a specific money management fee, we have an adviser fee and we're sharing some of those fees with the fund managers.

Typically, if you engage a fund manager to run an SMA, they will run it at a lower cost than a managed fund, but there is a lot more room to negotiate on a managed fund if you have a managed account – and certainly, if you have scale.

But it's important to note that managed accounts are not cheaper for your clients. It's not a way to save your clients money. Instead, it's about improved technology to run their portfolios.

3. Significantly reduced administration

As clients have now given us discretion to make trades on their behalf, there is now less need for ROAs and significantly reduced administration.

> “So, one of the biggest decisions for businesses is: Do you want to be your investment committee or do you want to outsource it to a specialist? That's an important decision the business needs to make.”

4. A consistent portfolio offering

Managed accounts enable us to have a consistent offering for our clients.

5. Advisers can advise once again

We launched our managed account offering in February 2017. This has enabled our advisers to actually advise again and not be money managers.

Advisers are not principally money managers. If you look at designations like the CFP® Certification, they are not money management qualifications. Financial planners are not geared to pick stocks, understand correlation and diversification challenges, and understand option pricing theory. It's not what they should be doing.

So, at Stanford Brown, our advisers are advising again, and they're really enjoying that.

The Lunar Managed Account

The following is a snapshot of Stanford Brown's Lunar Managed Account that we launched early in 2017.

We have five models – from conservative to high growth – and we are introducing low cost ETF-only models.

The five models are managed by a very experienced investment committee of five. Indeed, for businesses thinking about going down the managed account path, the type of investment committee you go with is critical.

So, one of the biggest decisions for businesses is: Do you want to be your investment committee or do you want to outsource it to a specialist? That's an important decision the business needs to make.

With our managed account, we have twice the ability to de-risk as we have to go up, and that's mandated. For example, if our client risk profiles are moderate, say 50/50, and we're maximum bullish on markets, we

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can go up to 65 per cent on growth assets. If we're maximum bearish on markets, we can go down to 20 per cent. For us, it's about meaningful dynamic asset allocation and particularly on the downside.

Our managed account uses a mix of ETFs (about 60 per cent), active managers and some direct investments.

However, as a word of warning, managed accounts don't do illiquid assets very well. I think the next evolutionary wave of technology might fix that, but as it stands, one month settled assets are a bit of a problem for most managed accounts.

So, I believe our Lunar Managed Account offers value in three places, which are:

- dynamic asset allocation;
- manager selection; and
- quarterly rebalancing.

18 months later…

So, it's been almost 18 months since Stanford Brown introduced managed accounts to the business, and the reaction from advisers and clients has been interesting.

Surprisingly, managed accounts hasn't suited all our advisers. We have 15 advisers, ranging from those who love the money management aspect of the advice process and believe they provide plenty of value to the client, to those who have no interest in the money management side of the advice process and are happy to delegate that aspect to a specialist.

So, on that spectrum, there were advisers who strongly resisted managed accounts, believing they'll have less scope to recommend changes to their clients.

> "It's important to note that managed accounts are not cheaper for your clients. It's not a way to save your clients money. Instead, it's about improved technology to run their portfolios."

However, as an important point, our managed account offering doesn't comprise 100 per cent of our clients' portfolios. It represents about 70 per cent and we tailor the rest according to the client's situation. So, for most of our client portfolios, the core component is now the managed account.

Another thing that our advisers find incredibly confronting with managed accounts is the transparency of performance. So, every single basis point is now accounted for. We also benchmark our performance to the Vanguard index and CPI.

So, while not all of our advisers love managed accounts, they are learning to love them. That's because the most important part of the equation – our clients – love them.

In terms of improvements to our administration and paraplanning, managed accounts have been fantastic. Our administration team had been growing, which was quite concerning, but with the implementation of our managed account offering, that has stopped.

And we are now providing a consistent, professionally managed investment offering. So, if you're in a balanced risk profile, you will have a very similar portfolio to someone else of your age and risk profile.

What has been particularly gratifying to see is the reaction of our clients to our managed accounts offering.

When we initially made the decision to go down the managed accounts path, we met with clients to explain our reasons for doing this and the benefits for them. Naturally, we were expecting our clients to embrace this wonderful new technology, but they didn't. We were faced with resistance by clients.

Clients were concerned that we were going to make changes to their portfolio without telling them. So, for a lot of our clients, that was quite a confronting concept. But after a concerted client communication campaign, we won our clients over.

In the end, it all came down to trust. Our clients did trust us to make discretionary decisions on their behalf.

And, to an extent, we've also been lucky. That's because when we launched our managed account offering in February 2017, it was a bumper year for markets, with every asset class going up and performing exactly as expected.

For example, the Lunar High Growth model returned

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Top 7 tips

The following are some handy tips for any business looking to roll out a managed account offering.

1. Do a lot of research. This includes talking to other businesses and platform providers.
2. Appoint an internal person to champion the transition process to managed accounts.
3. Test and trial everything.
4. Decide whether you want to establish your own internal investment committee or outsource it.
5. If you go down the internal investment committee path, then work out what your investment philosophy is.
6. Position the switch to your clients and your team – over and over again. You need to repeatedly communicate this move with your clients and staff, because people forget and it is confronting for clients to give up control of their portfolios.
7. Don't underestimate the resources you will need to successfully roll out this offering.

"So, my final advice to anybody making this tranistion to managed accounts is that this journey requires a lot of explanation and communication with your clients and staff. Stay close to them and be consistent in your messaging to them."

14 per cent last year. So, we had a wonderful first year performance across our Lunar portfolios, and with that has come a lot more client trust.

So, my final advice to anybody making this transition to managed accounts is that this journey requires a lot of explanation and communication with your clients and staff. Stay close to them and be consistent in your messaging to them.

Jonathan Hoyle is chief executive officer at Stanford Brown.

ETFs: The building blocks

Rob Coyte discusses how Shartru Wealth uses ETFs in its MDA offering.

At Shartru Wealth, our advisers have a wide and varied skill set. So, our challenge was to come up with a solution that would enable all our advisers to deliver advice to their clients that would provide them with the best possible investment solution.

When we started looking at the MDA structure, we were uncertain whether the benefits of an MDA would be as good as they actually were. However, when we started delving into the process of setting up our MDA, it became quickly apparent that this solution was going to greatly transform our business. In fact, it quickly exceeded all our expectations.

I believe a negative to services like platforms are the managers that limit your ability to invest in the sorts of assets that sit outside T+2 (trade date plus 2 business days) type arrangements. This means when we have GFC-type events, we end up with a correlation of assets of about one.

But at the end of the day, the only thing clients care about are the delivery of their objectives, which includes a sustainable income and the preservation of their capital.

In the process of setting up our MDA, it took us a long time to find a partner who shared our philosophy and was going to enable us to do what we wanted to do.

It took us about one year to go through the various players, before deciding on the final selection of organisations we were going to partner with.

Today, the MDA provides us with a mechanism to be able to provide consistency and a timely solution for our advisers and their clients.

We have a core satellite approach, with a passive and active component to that. We also have a very strong belief in the correlation of assets.

Why ETFs?

At Shartru Wealth, we use Exchange Traded Funds (ETFs) inside our MDA. So, why use ETFs?

Well, for one thing, ETFs have changed the way we go about doing things quite dramatically. There are active ETFs, passive ETFs, broad ETFs and specific ETFs. In fact, the only thing that can limit what can be put in an ETF is the product provider's imagination, which is generally prompted by advisers asking them for certain solutions.

ETFs tick all the boxes: they are easy to use, they are cost-effective, they are easy to execute, they are transparent and they are regulated.

ETFs in the core

At Shartru Wealth, ETFs have provided us with a lot more variety in terms of how we go about building

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portfolios, as well as our core approach to managing money.

For example, we have a certain view on Australian banks and where they're sitting at the moment. So, does it make sense for us to have a position of about 40 per cent of our core in those banks? Definitely no.

Instead, we simply have an equal weight ETF and by doing so, that dramatically reduces our exposure to banks in our core, without changing the underlying premise of what the core is. There's no buying and selling.

So, this enables our advisers to explain to their clients about why we have reduced our exposure to the banks, and clients are happy that their adviser is engaging with them in respect to what is happening in the markets.

ETFs are that easy and quick to use. So, if you don't like Wesfarmers, Telstra or the banks, and you want to get exposure to companies outside the Top 20, then ETFs are the solution. ETFs enable you to skew your portfolio very simply.

We've got a whole range of filters that can be applied to investments, such as the core. So, instead of having market capitalised indexes, we can have particular filters. For example, our view of the world is there's probably a little bit too much debt out there at the moment. So, there are filters in ETFs you can utilise to reduce your exposure to such companies. For us, that makes sense.

Also, if we want to increase our leverage, we could get a geared exposure to the market by using a geared ETF. Naturally, you'd be unwise to do that at this point in time but nonetheless, it's an option.

ETFs for satellites

Once we settled on our core position, we then looked at what we're doing in regards to our satellites. We had positions in Japan and Europe. So, in terms of our international exposure, by buying an appropriate ETF, you're effectively skewing your portfolio, taking a satellite position to reflect that view. It's done with one trade, it's done very easily, it's done very cheaply and it's done efficiently.

For example, as soon as the Japanese Government announced it anticipated the popularity of bitcoin would mean the Japanese economy was expected to grow by 0.3 per cent, you can then get in and sell the Japanese exposure very quickly, which benefits your clients.

> "In fact, the only thing that can limit what can be put in an ETF is the product provider's imagination, which is generally prompted by advisers asking them for certain solutions."

In regards to hedging, you can actually take short positions in your portfolio to manage risk, which I think is a tool that a lot of financial advisers are using at the moment. You can also use it to take a speculative view. At Shartru Wealth, we use hedging in terms of managing risk.

Also, there's a whole range of ETFs that effectively enable you to get one-for-one or one-for-three exposure. So, by owning a 10 per cent exposure to a short, you can actually protect one-third of your portfolio.

These are the types of tools you can easily utilise in line with your investment philosophy. It enables you to actually deliver what you are saying to clients.

There's also the opportunity to take positions in sectors like gold. Once again, it's only the imagination of product providers that will limit what you want to do with ETFs.

Technology play

Another significant issue coming into play is technology innovation and being able to access different forms of assets that we traditionally haven't been able to do.

For example, we use the DomaCom platform in our MDA. We're looking to do some direct property transactions in that – both debt and equity. By doing so, that will give our investors the ability to participate in assets that are going to give them an entirely different risk/return profile to what they can get elsewhere.

So, as a structure, MDAs are excellent. In fact, I predict that within five years, everybody in the industry will be using them. My advice is, if you're not offering MDAs, then get onto them!

Rob Coyte CFP® is Chief Executive Officer at Shartru Wealth.

Marketing a new managed accounts program

Toby Potter outlines the steps required to effectively communicate and market a new managed accounts program to advisers and clients.

When licensees consider developing a managed accounts program as a replacement for the conventional advice/recommendation-based process, they are often concerned by the challenges they expect to have in ensuring their advisers are as committed to the project as they are.

Overcoming these issues requires licensees to address the issue in two ways:

- Overcoming advisers' fears and objections; and
- Equipping advisers to communicate the benefits of the service to clients, particularly to existing clients who have previously been receiving a different form of service.

Adviser questions

Let's first consider the concerns that arise among advisers. These can be grouped into a number of areas:

Role perception

"Will this service undermine the way in which my clients regard me?", or

"What type of relationship will I have with my clients if they don't see me as the person who selects their investments?"

Customisation of the service by client

"My clients have unique circumstances and lots of them have other investments or specific preferences, which need to be taken into account when their portfolio is being constructed."

Fee concerns

"The proposed fee structure will be hard to explain to my clients. They are used to seeing only my advice fees and the platform fees, and they understand that there are costs in the funds they hold."

Best interest issues

"How can I recommend an in-house service? Will this truly be in my clients' best interests?"

It's clear that the answers to these legitimate questions will vary depending on the service structure that the licensee adopts.

For example, if the managed account service adopted is simply a decision to include a number of third party managers' SMAs from the licensee's preferred platform onto the APL, then issues of the adviser's role, customisation and best interest are unlikely to be significant.

The adviser will be recommending an SMA in the same way as they might have recommended a managed fund. Their role in portfolio construction is supported and the adviser is able to explain the benefits of this structure, compared to pooled unit trusts.

The explicit cost may be an issue but again, pooled unit trusts and their indirect cost ratio (ICR) provide an appropriate reference point. Since the licensee is not earning a margin or other benefit from the SMA provider, questions of conflict are very unlikely to arise.

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However, the 'role perception' question can arise when the SMA is directly equivalent to the type of portfolio that the adviser typically includes in their advice.

For example, a direct equities SMA managed by an external manager, if directly held equities are common in clients' portfolios or a balanced multi-asset class SMA – often constructed by research houses using ETFs, if this is equivalent to the adviser's investment approach.

The questions highlighted above can arise most acutely when the licensee is directly involved in the portfolio management and construction process of the managed account. This might be a set of SMAs that are specific to and branded for the licensee or it may be an MDA service where the licensee is either the MDA provider directly or has an arrangement to provide advice on a set of portfolios that the licensee manages through a third party MDA provider.

In this case, the roles of asset allocation and manager selection are taken on by the licensee and its investment committee, or by a research house or portfolio manager that it selects.

Client questions

This section of 'client questions' should really be called, 'Adviser concerns about client concerns'. They are the concerns that an adviser might think a client, particularly an existing client, might have when the adviser recommends the use of managed accounts – SMAs or MDAs – instead of a purely advised portfolio. These might include:

Perceptions of the actual service offered

"I thought you were doing that already."

Cost concerns

"How will the cost compare to my current costs?"

Investment concerns

"Will this still support my preference for (sustainability/not selling this existing holding/ethical investing)?" Obviously, the actual issue they raise will be particular to their circumstances.

> "In a service proposition, such as advice generally and managed accounts in particular, there are three key ways of responding to and dealing with objections."

Dealing with objections

In a service proposition, such as advice generally and managed accounts in particular, there are three key ways of responding to and dealing with objections. These are:

- Rational responses – Having an answer to the specific issue raised;
- Emotional responses – Coaching on behaviour change; and
- Experiential responses – Conduct over time that demonstrates that the issues raised are less significant than imagined and the benefits achieved are real.

So, in addressing the issues raised above:

Role perception – The licensee that wants to address this can concentrate on responding with answers such as:

"This will free you up to focus on those issues that really can make a difference to the client, such as strategic advice and good structures."

"This moves your conversations with clients away from a focus on either a specific investment recommendation or the performance of your portfolio selections."

Customisation – Most managed accounts programs now support a greater or lesser degree of customisation, such as exclusions and substitutions, or running advised assets and managed account assets in the same or linked accounts. The answer here will depend in large part on the technology. However, a linked issue is the desire of advisers to reflect their own views in their client's portfolios.

For example, a stock which has a good dividend yield may be avoided by portfolio managers because they believe it to be at risk of capital loss. There are a number of examples of this in the Australian market. Licensees will need to develop their policy on the extent to which they will be prepared to allow advisers to depart from portfolio positions.

Fee concerns – As an issue that has a demonstrable answer, the question of client cost will need to be addressed explicitly. Frequently, the introduction of managed accounts has been accompanied by a realignment of costs, which has meant that clients are now worse off and are receiving a better service.

Best interest issues – Best interest issues can express themselves in a reluctance to recommend an 'in-house'

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service. Appropriate responses will stress that the resources the licensee has implemented are to ensure the portfolios are as good as they are able to provide.

"The portfolios are our best views on the portfolios, which a client should hold."

"In this way, we can ensure that as our views change, we can implement those changes immediately and at least cost."

"We have outsourced those parts of the portfolio management, such as security selection, to those managers we think are most likely to meet the portfolio objectives."

Behaviour change

This is best achieved by both repeated demonstrations and by making the experience of other advisers available to those advisers who remain to be convinced.

The experience of client outcomes achieved through portfolio management and practice efficiencies, which other advisers experience, needs to be captured and related at professional development days and in other regular updates on the managed account service.

Of course, the most powerful advocacy vehicles for the managed accounts service will be the support of other advisers. Firsthand experience from other advisers who have implemented managed accounts for new clients and then experienced the benefits that they (and their clients) achieve from not having to manage their client accounts on a one by one basis, is powerful.

Experiential responses

The best support for the introduction of a managed accounts program can be achieved through:

- continuing to advocate for the service over a period of several years;
- providing good communication support on the performance of the portfolios and about portfolio changes; and
- ensuring that the experiences of early adopting advisers are shared.

Summary

Making a success of marketing a managed accounts program to advisers and clients is a result of understanding the issues that might be raised about the changes that it entails. Addressing these in a multi-layered way – with rational, behavioural and experiential elements – is key to gaining commitment from the key audience, the advisers.

Toby Potter is Chair of IMAP.

> Since the licensee is not earning a margin or other benefit from the SMA provider, questions of conflict are very unlikely to arise.

Upcoming Events

The 2018 IMAP Managed Accounts Awards

When: 1 August - 6:00pm-9:00pm

Where: Dockside Convention Centre, Cockle Bay Wharf, Sydney

The inaugural IMAP Managed Accounts Awards will be held in Sydney on 1 August 2018, to coincide with the 2018 IMAP Portfolio Management Conference on 2 August 2018. For more on the IMAP Portfolio Management Conference, go to p38.

The 2018 IMAP Managed Accounts Awards cover both single sector asset classes and multi-asset class programs, which generally have a range of risk profiles or other goal-based objectives.

In addition, there will be awards specifically for managed account programs offered by advisory firms that are integrated into the advice process.

The categories that recognise individual AFSL or practice managed account programs will cover both those that are fully managed internally, as well as those where portfolio management or investment management is outsourced.

Both SMA and MDA programs, along with the other legal structures used by managed account providers, will be included in the awards.

This year's awards will be judged across three categories:

1. Asset Class portfolios;

2. Single AFSL/Dealer Group portfolios; and

3. Innovation

2018 IMAP Portfolio Management Conference

When: 2 August – 8:45am-5:00pm

Where: Dockside Convention Centre, Cockle Bay Wharf, Sydney.

The IMAP Portfolio Management Conference is a specialist event for dealer principals, adviser group management teams and advisers. It focuses on the Portfolio management aspects of managed account programs.

Sessions include:

- **Session 1: Making investment promises you can keep**
  Chair: Tom Bignill, Mason Stevens

Hear from a panel of advice businesses that have untangled many of the complicated issues that can arise when building managed account solutions, resulting in customisable and scalable solutions that are client centric.

- **Session 2: Portfolio construction asset allocation game**
  Speaker: Oliver Trusler, Schroders

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Working in teams, conference attendees will be asked to provide portfolio construction recommendations for a number of market scenarios.

- **Session 3: Vertical dis-integration – Leaving the mothership**
  Guest Speaker: David Wright, Zenith
  Guest Chair: Paul Saliba

As the advice landscape changes, what are the challenges and opportunities as advisers go out on their own?

- **Session 4: The role of sector exposure in an Australian equity portfolio**

What opportunities are available in the listed equity space and how do you utilise these tools and strategies?

- **Session 5: Practical application of international equity exposure in managed accounts**
  Chair: Nigel Douglas

This presentation will discuss the implementation of international equities, including execution, custody and reporting solutions, for a managed account provider.

- **Session 6: Meeting retirement income objectives through managed accounts**
  Chair: Michael Karapianis, NAB PIC
  Guest Speakers: Lukasz de Pourbaix, Lonsec and Raf Choudhury, SPDR

Presenters will discuss what set them on a managed account journey for retirement income solutions, how they did it and what they learnt from the experience.

- **Session 7: Outside the mainstream – Looking for particular portfolio characteristics**
  Chair: Angela Ashton

- **Session 8: 2023 – What will investment management look like for advisers?**

Challenges, tips and traps on setting up investment committees, the role of the adviser, and how to ensure portfolios are robustly constructed and appropriate to client objectives.

- **Session 9: Methods of allocation/portfolio construction and economist panel**

This full day managed accounts conference has been specifically designed for:

- Advisers;
- Investment committee members;
- AFSL business owners looking to reposition their business;
- AFSL holders who are authorised to operate MDA services; and
- Investment managers who want to understand how managed accounts are transforming advice.

For more information on these events or to register your attendance, go to imap.asn.au/events

IMAP hosts leading managed account educational events, including webinars for dealer principals and advisers, advice roadshows, practitioner forums and the Responsible Manager Masterclass. For more information, go to imap.asn.au

IMAP 2018 PORTFOLIO MANAGEMENT CONFERENCE

2 AUGUST 2018 — DOCKSIDE CONVENTION CENTRE

REGISTER NOW

The full day IMAP Portfolio Management Conference is a specialist event for dealer principals, chief investment officers, adviser group management teams and advisers.

Topics presented by specialist managed account professionals include:

- **Making investment promises you can keep** – Tom Bignill (Mason Stevens), Dan Miles (Innova Asset Management) and Alex Horne (Atrium)
- **Vertical Dis-integration: Leaving the mothership** – Paul Saliba (Evolutionary PS), David Wright (Zenith) and Alex Donald (Ironbark)
- **The role of sector exposure in equity portfolios** – Cesar Farfan (Perennial), Jerome Lander (Pro Capital) and Charles Stodart (Zurich)
- **Practical application of IE exposure in MAs** – Nigel Douglas, Nik Kritikos (Saxo) and State Street Global Advisors Active
- **Meeting Retirement Income Objectives through Managed Accounts** – Michael Karagianis (NAB PIC), Lukasz de Pourbaix (Lonsec) and Raf Choudhury (State Street Global Advisors SPDR)

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ZURICH

Contact us: Jayson Forrest
M: 0416 039 467
E: jaysonjforrest@gmail.com